

**Before the  
Federal Communications Commission  
Washington, D.C. 20554**

<b>In the Matter of</b>	)	
	)	
<b>Implementation of the</b>	)	<b>WC Docket No. 03-225</b>
<b>Pay Telephone Reclassification</b>	)	<b>RM No. 10568</b>
<b>and Compensation Provisions of</b>	)	
<b>The Telecommunications Act of 1996</b>	)	

**WORLDCOM, INC.  
COMMENTS**

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## I. EXECUTIVE SUMMARY

Although the number of payphones has significantly declined since 1999, PSPs have failed to provide evidence that this decline has impeded the public's ability to make transient phone calls. When the Commission first calculated its cost-based DAC rate, it relied on state commission determinations that the number of payphones deployed at the time was sufficient to serve the public interest. The Commission also relied on state's conclusions that market forces would adjust the supply of payphones to appropriate levels. Since then the public's need for payphones in order to make transient phone calls has significantly declined. There is no evidence that states have found the PIP programs or market mechanisms unable to accommodate the public's need for payphones since 1998. However, if the Commission now believes that these mechanisms permit payphones to be removed from locations where they are needed, it should require states that do not have PIPs to implement such a program, and consider requiring all states to better advertise the availability of their PIP and advertise how to request a subsidy for a needed payphone. The policy proposed by Petitioners, namely doubling the dial around compensation rate will only further reduce the number of payphones, and will fail to ensure that additional payphones will be placed at locations where they are needed, if in fact there is a need for payphones at specific locations.

In the event, that the Commission forsakes this approach and chooses to modify the default compensation rate, it should find that Petitioners have overstated costs in a number of ways. RPC fails to estimate the capital costs of acquiring and installing a payphone. APCC performs this task, but failed to take into account the availability of much less expensive new and refurbished payphones, pedestals, and enclosures.

The Commission should not include a cost recovery element for bad debt, because in its Fifth Reconsideration Order it has already determined that Section 276 does not permit one company to bear another company's expense. Including an element for bad debt would unfairly shift the burden of non-paying local exchange carriers ("LECs") and interexchange carriers ("IXCs") onto those that do pay. Neither should it include a cost recovery element for collection costs. The RBOC Payphone Coalition ("RPC") estimate should be rejected because it includes functions that are performed by interexchange carriers, but are not necessary functions for payphone service providers. APCC's element should be rejected because its survey did not direct responders to exclude such costs from sales, general, and administrative costs ("SG&A").

The Commission should also make adjustments to correct for the downward bias in call volume estimates provided at marginal locations. APCC measures volumes of calls at marginal payphones according to dial around calls for which PSPs received compensation, and excludes completed calls for which they did not receive compensation. Both Petitioners fail to exclude call volume data from locations that did not fully recover their costs, one of the conditions the Commission has used to define marginal payphones. Consequently, both studies may include phones with sub-marginal volumes. The Commission should request RPC and APCC resubmit their studies based on data derived from samples that do not contain the call volume errors identified here, or should use average call volumes as a reasonable adjustment.

The Commission should also reduce the default compensation rate by the extent to which coin revenues exceed the rate sufficient to recover costs plus a normal return. The purpose of the Commission's default compensation rate is to return a rate that allows a PSP to recover costs plus a normal return, but no more. PSPs would be over-recovering the extent to which coin revenues exceed the per-call cost calculation.

If the Commission were to make the adjustments recommended herein, it would find that the existing default rate of \$.24 per call would be sufficient to fully recover the costs of a payphone at an average location. If the Commission were to use the marginal call data supplied by RPC and APCC, even though their samples include sub-marginal phones and so bias call volume downward, MCI shows that \$.33 per call would be sufficient to fully recover the costs of a payphone at a marginal location.

## II. INTRODUCTION

WorldCom, Inc., d/b/a MCI, takes this opportunity to respond to the questions and issues raised in the Commission's Notice of Proposed Rulemaking ("NPRM"), which was issued in response to Petitions for Rulemakings by the American Public Communications Council ("APCC") and the RBOC Payphone Coalition ("RPC"). These petitions asked the Commission to increase the dial-around compensation rate from \$.24 to \$.484 and \$.49 respectively.<sup>1</sup> Both representatives of payphone service providers ("PSPs") estimated that call volumes for both coin and coinless calls at marginal payphone locations declined approximately 50% between 1998 and 2002, while the costs of purchasing, installing, and maintaining a payphone remained essentially unchanged.<sup>2</sup> The result, they maintained, was a decline in profitability and the removal of somewhere between 11% and 22% of payphones between 1998 and 2002.<sup>3</sup>

The PSPs attributed this estimated decline in usage solely to the increasing substitution of wireless calling for payphone calling.<sup>4</sup> Parties commenting on their petitions agreed that the

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<sup>1</sup> Request That The Commission Issue A Notice Of Proposed Rulemaking Or In The Alternative, Petition For Rulemaking, APCC, August 29, 2002 ("APCC Petition"); Petition For Rulemaking, RBOC Payphone Coalition ("RPC Petition"), September 4, 2002.

<sup>2</sup> RPC Petition, Attachment at 12; APCC Attachment 1 at 13; and Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996, Third Report and Order, and Order on Reconsideration of the Second Report and Order ("Third Report & Order"), CC Docket No. 96-128, Released February 4, 1999, & 147.

<sup>3</sup> RPC Petition at 4, APCC Petition at 8.

<sup>4</sup> RPC Petition at 1, APCC Petition at 8.

rapid decline in the price of making a wireless call was the primary reason explaining the decline in payphone calling volumes, although not the sole reason.<sup>5</sup>

As the Commission notes in its NPRM, there is little dispute that industry conditions have changed significantly since the Commission determined that \$.24 per dial around call would reimburse payphone owners for the cost of supplying a payphone at a marginal location.<sup>6</sup> The dispute centers on whether the substitution of wireless for payphone use, and the resulting decline in the number of payphones: 1) has caused a decline in the number of payphones required to serve the public's need for payphones so that even further decline would not jeopardize the public's ability to make transient calls, or has caused a decline that has left the public in need of possibly more payphones, and 2) whether the reduction in the cost of buying, installing and maintaining a payphone, coupled with increases in payphone revenues from sources other than dial around compensation ("DAC"), have offset the decline in payphone calling volumes.

In these comments MCI will first show that there is no evidence that the decline in the numbers of payphones since 1998 has prevented a single person from making a payphone call, that raising the dial around compensation rate will not stem the tide in payphone removal, and that doing so would be an inappropriate method of dealing with a declining regulated industry. Secondly, MCI will show that the combination of declining forward looking costs of providing payphone service combined with the additional revenue PSPs gain from sources other than dial around compensation justifies a dial around compensation rate equal to \$.24 per call.

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<sup>5</sup> See, e.g., WorldCom Comments on APCC and RBOC Coalition Petitions For Rulemaking, ("WorldCom Comments"), RM No. 10568, October 3, 2002, at 11.

<sup>6</sup> NPRM at & 18.

III. TARGETTED SUBSIDIES TO PAYPHONES AT LOCATIONS WITH DEMONSTRATED NEED BUT INSUFFICIENT DEMAND IS THE APPROPRIATE POLICY MECHANISM TO ENSURE THE WIDESPREAD DEPLOYMENT OF PAYPHONES IN THE FACE OF WIRELESS COMPETITION

A. The Commission Chose Its Cost Model On Its Belief That States Had Already Determined The Number Of Payphones Needed To Satisfy The Public's Need For Transient Calling

Section 276 of the Telecommunications Act of 1996 ("Act") was established to promote "widespread deployment of payphone services to the benefit of the general public."<sup>7</sup> The Act also required the Commission to determine "whether public interest payphones, which are provided in the interest of public health, safety, and welfare, in locations where there would otherwise not be a payphone, should be maintained, and if so, ensure that such public interest payphones are supported fairly and equitably."<sup>8</sup>

Based on a preliminary survey of state public interest payphone programs ("PIPs"), the Commission found in 1996 that many states had already developed systems to determine whether the ability to call from a payphone was being denied to the public.<sup>9</sup> The Commission required states to review and report by the end of 1998 whether they had adequately provided for the ability of the public to make calls from payphones.<sup>10</sup> By the end of 1998, nine states established programs to fund the placement of payphones at approved locations that would not

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<sup>7</sup> 47 U.S.C. § 276(b)(1).

<sup>8</sup> 47 U.S.C. § 276(b)(2).

<sup>9</sup> Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996, CC Docket No. 96-128, Report and Order ("First Payphone Order"), Released September 20, 1996, & 278.

<sup>10</sup> Id., & 285.



otherwise have one,<sup>11</sup> and three states required local exchange companies (“LECs”) to maintain one payphone in each exchange.<sup>12</sup> The remaining states determined that market forces were able to supply payphones to the proper locations so that the public would be able to make payphone calls.

Having assured itself that state mechanisms or market forces were in place to deal with any reduction in the number of payphones that might adversely impact the public interest or safety, the Commission felt justified in making the preservation of the approximate number of payphones in existence as its goal when it established a cost-based default dial-around compensation rate in 1999. The Commission stated that “the current approximate level of payphone deployment most appropriately satisfies Congress’s stated goal of promoting widespread deployment of payphones to the benefit of the general public. This conclusion is supported by the filings of several states that have...concluded that the current deployment of payphones is adequately meeting the needs of the public.”<sup>13</sup>

This in turn formed the basis for the Commission’s decision to set the default compensation rate equal to a rate that would just recoup the average costs of a payphone plus a normal return, but not allow a payphone owner to afford commission payments to location owners. Thus, the Commission calculated the default compensation rate equal to the joint and common monthly costs for a typical payphone divided by the number of calls made per month at

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<sup>11</sup> Alaska, California, Indiana, Louisiana, Michigan, Nebraska, New Hampshire, New York, and Wisconsin.

<sup>12</sup> Arkansas, Kentucky, and West Virginia.

<sup>13</sup> Third Report and Order & 143.

the “marginal location.”<sup>14</sup> The Commission rejected using average call volumes because doing so “would cause many payphones with less than average call volumes to become unprofitable.”<sup>15</sup> In summary, the Commission’s cost model required a prior determination of the appropriate level of payphone deployment, and it relied on states to make that determination. While many states had PIPs in place in case payphone removal harmed the public’s need to make transient phone calls, most states believed that market forces would supply the appropriate number of payphones to service the public’s need for transient calling. By not requiring states to implement PIPs, the Commission also accepted the view that market forces would work to adjust the supply of payphones to the public’s need for them.<sup>16</sup>

B. The Commission Should Require States To Implement Public Interest Payphone Programs If It Now Believes Market Forces Will Not Ensure The Widespread Deployment Of Payphones

All parties have acknowledged that the decline in the affordability of wireless calling compared to making payphone calls is the primary factor accounting for the decline in payphone calling volumes, the resulting decline in profitability, and the removal of unprofitable payphones from service. The relative affordability of wireless compared to payphone calling today is substantial. In 1997 the average price of a wireless call was \$.38 and the average price of a local

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<sup>14</sup> Id., &191.

<sup>15</sup> Id., & 141.

<sup>16</sup> Relying on market forces is not the same thing as complete deregulation, involving market negotiations between interexchange carriers and PSPs to set compensation on a PSP or even ANI specific level. The Commission knew in 1999 that interexchange carriers were not able to implement PSP-specific or ANI-specific call blocking, and yet endorsed states that relied on market forces to establish the appropriate level of payphone deployment.

coin or dial around payphone call was \$.35.<sup>17</sup> By 2002, the average price of a wireless call had dropped to \$.11 and the average cost of a local coin or dial around payphone call had increased to \$.43 per call.<sup>18</sup> The average wireless call is now four times less expensive than a payphone call. No wonder the number of payphones has declined since the Commission set the default dial around compensation rate in 1999.

Petitioners request the Commission to raise the default compensation rate to a level that would ensure the profitability of currently marginal payphones. The implication of this request is that the current number of payphones is adequate to serve the public interest. Yet, RPC anticipates competition from wireless services will further reduce the supply of payphones.<sup>19</sup> It is obvious, and undisputed by any party, that the public's need for transient calling is increasingly being met by wireless services. The public's need for payphones is declining and will continue to decline.

In this environment, maintaining the current level of payphones is poor public policy, and certainly not required by Congress. The opposite is actually the case. Section 276(b) requires the Commission to ensure the widespread deployment of payphones *in the public interest*. If the public's interest in using payphones has declined as a result of legitimate competition, the Commission must incorporate this reduced level of "interest" into its analysis of what is the approximate level of payphones required to serve the public's need for transient calling. The

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<sup>17</sup> See, FCC, Trends Report, 2003, Table 11.1 for the average price of a wireless call.

<sup>18</sup> This reflects the weighted average of coin (\$.50) and dial around (\$.24) calls. See APCC Petition for relative weights of coin and dial around calling located at its Attachment labeled "Summary of Average Call Volumes, by Call Type.

<sup>19</sup> RPC Petition at 6.

Commission has previously recognized that competition from wireless services might reduce the number of payphones, and concluded that if any policy action were required in response to competition, it should take the form of targeted subsidies administered via state administered public interest payphone programs.<sup>20</sup> The Joint Board on Universal Service came to the same conclusion. In the proceeding where it examined whether new services ought to be added to the definition of services supported by universal service, the Joint Board acknowledged the decline in payphones, yet concluded that any increased payment directed broadly to most payphones would merely represent a windfall to the payphone industry.<sup>21</sup> The Joint Board further stated that public interest payphones were the appropriate vehicle to respond to the public's need for continued access to payphones in light of declining payphones due to competitive alternatives.

MCI advocated the same approach as the Commission and the Joint Board in its Comments to PSP petitions. Far from advocating complete deregulation of the payphone market, which MCI recognizes is not a possibility, MCI advocates allowing competition from wireless providers to proceed without hindrance, allowing payphone providers to either remove unprofitable payphones or petition state commissions for subsidies where such removal would mean the absence of a necessary payphone.<sup>22</sup> When other payphones remain near those that have been removed, call volumes will increase. If the resulting call volume increase is insufficient to allow the remaining payphones to recover their costs, more payphones will be

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<sup>20</sup> Third Report & Order, fn 282.

<sup>21</sup> Federal-State Joint Board On Universal Service, Recommend Decision, CC Docket 96-45, Released July 10, 2002, &50.

<sup>22</sup> WorldCom Comments at 4-7.

removed, call volumes will increase further, and bring increased revenues for the remaining payphones.

If demand for a payphone use is positive, but too low to support the presence of any payphone in an area, it would be necessary to subsidize that payphone. Targeted subsidies to support needed, but unprofitable, payphones is the appropriate mechanism to ensure the widespread deployment of payphones in the public interest in the face of competition from wireless providers.<sup>23</sup> In 1999, the Commission accepted the judgment of state commissions who had not adopted public interest payphone programs that market forces would ensure the widespread deployment of payphones. The Commission also established a mechanism for parties to petition and assert that the “state is not providing for payphones in accordance with Section 276(b)(2).”<sup>24</sup> If the Commission is now concerned that market mechanisms are causing the removal of payphones where other more affordable alternatives (such as wireless calling) are not available, it should state its intention to seriously entertain petitions for a state to establish a PIP. Any party, including a PSP, should be able to make such a petition. The statute also allows parties to petition the Commission if they believe a state’s PIP is inadequate to serve the public’s need for payphones. To date, Petitioners have only pointed to the decline in the numbers of payphones and alluded to their importance, but have failed to provide any evidence that the public is being harmed by the decline in payphones. If the public is being harmed, PIPs are the appropriate policy mechanism to respond to this deficiency.

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<sup>23</sup> NPRM, & 19.

<sup>24</sup> Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996, CC Docket No. 96-128, Released September ??, 1996, Report and Order (“First Report & Order”), & 286.

C. Analysis Of The Impact Of Increasingly Affordable Wireless Service Plans On Payphone Levels Suggests That Raising The Default Dial Around Rate Would Not Stem The Decline In Payphone Deployment

In its NPRM the Commission asks parties to provide more data on the relation between the dial around compensation rate and the removal of payphones.<sup>25</sup> MCI performed a semi-log estimation of this relation by regressing the natural log of the ratio of the price of an average wireless call to that of an average price of local coin and dial around calling against the supply of payphones. Data for the estimation is presented in Table 1 below.

<b>Table 1</b>							
<b>Wireless and Payphone Rates 1997-2003</b>							
Year	Average Wireless Rate*	Coin Rate	DAC Rate	Blended Payphone Rate**	Ratio Wireless to Payphone Rates (W/P)	Payphones***	Ln (W/P)
1997	0.38	0.35	0.35	0.35	1.09	2,086,540	0.086
1998	0.37	0.35	0.284	0.33	1.10	2,100,558	0.094
1999	0.29	0.35	0.24	0.32	0.90	2,121,526	-0.103
2000	0.22	0.35	0.24	0.32	0.69	2,063,718	-0.366
2001	0.18	0.35	0.24	0.32	0.55	1,919,640	-0.593
2002	0.12	0.5	0.24	0.43	0.29	1,711,061	-1.244
2003	0.11	0.5	0.24	0.43	0.26	1,495,786	-1.339

Sources:

\* FCC 2003 Trends Report, Table 11.3

\*\* Weighted average of DAC and coin rate, weights from APCC Petition, "Summary of Average Call Volumes, by Call Type."

\*\*\* FCC 2003 Trends Report, Table 7.6

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<sup>25</sup> NPRM & 28.

The impact of increasing the DAC rate on payphone deployment can be derived from parameters from the regression,

$$\text{Payphones} = 2,117,128 + 381,357 \ln (W/P)$$

where  $W/P$  is the ratio of the average price of a wireless call to the weighted average price of a local and dial around call.

Raising the DAC from \$.24 to \$.49, and assuming that the price of an average wireless call remains constant at \$.11, reduces estimated payphones from 1,606,593 to 1,553,132, a 3.4 percent loss of payphones. Rather than raising the number of payphones deployed as Petitioners hope, their recommendation will slightly reduce the deployment of payphones. For the same increase in DAC, the decrease in payphone deployment will grow at an increasing rate if the price of wireless service continues to decline. If the average price of a wireless call were to fall by \$.02 next year to \$.09, payphones' estimated deployment resulting solely from the DAC increase would reduce estimated payphones by 3.6 percent rather than 3.4 percent.<sup>26</sup>

While doing nothing to spread the deployment of payphones, the proposed DAC increase would harm business and consumer users of dial-around calling. For example, many states directly deposit welfare benefits into accounts that are accessed via a subscriber 800 number. The cost to these state agencies would significantly increase if the dial around compensation rate were doubled. Prepaid card users would be especially hard hit as a result of the economics of

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<sup>26</sup> Estimated deployment would fall by 8.8% if both the cost of wireless service fell by \$.02 and DAC increased to \$.49. The calculation in the text compares the estimated losses in payphone deployment for the same wireless to payphone service price ratio.

this industry. Retail distributors of prepaid cards typically receive one-half of the value of the card. Thus, prepaid card providers typically include a surcharge of \$.50 for calls made from payphones today. This would increase to \$1.00 if the PSPs proposal were implemented.

#### IV. PROPER ESTIMATION OF THE AVERAGE COST OF A PAYPHONE AT A MARGINAL LOCATION YIELDS A PER-CALL RATE OF \$.24

MCI firmly believes that the proper response to the public's declining need for payphones is to allow PSPs to withdraw unprofitable payphones from locations where other payphones exist, and allow PSPs, and other parties, to petition states to subsidize a payphone in danger of being removed if a party believes this is the only payphone in a locality. In order to ensure the success of this policy, the Commission would need to strengthen the reach of PIP programs at the state level. This should be done by requiring states to implement PIP programs if they do not have them, to advertise their availability, and advertise the procedures that are involved in requesting a public interest payphone. The Commission should also entertain petitions requesting states to improve their PIPs. However, in the event that the Commission forsakes this approach and chooses to modify the default compensation rate, MCI responds to RPC and APCC's cost estimates.

##### A. Payphone Capital Costs Have Significantly Declined Since 1999

In its Comments to the APCC and RPC Petitions, WorldCom pointed out that market conditions are dramatically different today than they were in 1999. Today there are more than 600,000 fewer payphones than existed at their peak in 1999.<sup>27</sup> Many of these phones are new or nearly new, sitting in inventory, and are available at significantly less cost than was the case in 1999. This factor, combined with reductions in labor cost and reductions in overhead, have

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<sup>27</sup> FCC 2003 Trends Report, Table 7.6.



significantly lowered the monthly costs of supplying an average payphone compared to 1999. In fact, given the large numbers of payphones removed from service, the only reimbursable capital costs that absolutely need to be incurred in order to supply a payphone to a marginal location would be the costs of removing the phone equipment from storage, installing the equipment, and paying the local exchange company to connect a payphone access line. Nevertheless, MCI estimated the cost of payphone equipment by identifying the cost of new, or refurbished, equipment that could be obtained from vendor web sites and advertisements for payphone equipment.

#### 1. Payphone Units

MCI performed a thorough search of web sites selling new, refurbished, and used payphone equipment at the time RPC and APCC cost studies were submitted, as well as more recently, and found the cost of new payphones varied from \$150 for a Bell coinless phone to \$310 for a Protel 310. Attachment 1 lists the 20 mostly new phones included with their advertisements. The average cost of a replacement payphone can be obtained for \$222.51. Nearly all phones had coin mechanisms, the installation costs of which were deducted according to calculations made by the Commission in its Third Report and Order.<sup>28</sup>

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<sup>28</sup> Third Report & Order, & 169. One advertisement also included new enclosures and pedestals. Their average price was deducted from the price of the phone in this case.

## 2. Pedestal

Mostly used and refurbished pedestals were identified in the survey, costing \$75.83 on average. It was possible to obtain a new pedestal for \$125. Attachment 2 contains the pedestal advertisements, prices, and sources.

## 3. Enclosure

Enclosures were found ranging in price from \$25 to \$125. It was possible to purchase a new enclosure for \$40. The average cost of a used enclosure was \$66.50. Attachment 3 contains the enclosure pedestal advertisements, prices, and sources.

## 4. Other Payphone Equipment Costs

Programming, Rate File, phone book, sign and back plate costs were taken from the “average” column in APCC’s study, as these elements did not consistently appear as separate items on the surveyed web sites, although rate files were often included in the price of the payphone. Thus, average Programming fees were included as \$45, average Rate File fees were included as \$23.67, and average phone book, sign, and back plate costs were included, totaling \$141.67.

MCI also used APCC’s probability of a marginal payphone requiring a pedestal or enclosure to weight these cost items. This aspect of the APCC survey correctly shows that many payphone locations do not invest in enclosures or pedestals, phone books, signs or backplates. This identifies one area identifies one area where the Commission’s previous cost study overestimated average payphone costs. MCI rejected RPC’s equipment costs as unreliable. RPC only investigated the cost of a new payphone unit, which it valued at \$250.<sup>29</sup> However,

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<sup>29</sup> RPC Petition at 6.

RPC did not attempt to estimate the cost of purchasing and installing other payphone equipment elements, but instead relied on data 1998 data submitted by Peoples and Davel.<sup>30</sup>

#### 5. Equipment Installation Costs

MCI estimated the average cost of installing a payphone, enclosure and pedestal as \$175 from data submitted in its Comments on APCC and RPC's Petitions for a rulemaking.<sup>31</sup> More recent data shows that it is possible to have a payphone, enclosure and pedestal installed for no more than \$250, the maximum price reported earlier. The earlier data remains a valid estimate of installation costs.<sup>32</sup> Attachment 4 contains the data on the cost of installing a payphone, enclosure, and pedestal.<sup>33</sup>

#### 6. Line Installation Costs

Once the payphone, enclosure, and pedestal are installed, a PSP will incur a non-recurring charge from the local exchange company for connecting a payphone access line. MCI reviewed the tariffs of Bell South, Verizon, Qwest, and SBC and estimated the average price for connecting a payphone access line as \$54.50.<sup>34</sup> Fees range from a low of \$12 to a high of

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<sup>30</sup> WorldCom Comments at 17.

<sup>31</sup> *Id.*, Appendix 7

<sup>32</sup> APCC failed to report installation costs in its study. APCC's survey is not designed to have participants exclude payphone installation costs from ongoing maintenance costs if the participant relied on in-house staff to perform the installation. .

<sup>33</sup> Installation prices vary depending on whether a pedestal or enclosure was installed. MCI's averaging of different installation prices reflects this variation.

<sup>34</sup> APCC also failed to report its LEC line installation costs.

\$175.<sup>35</sup> Data is reported in Attachment 5. Table 2 summarizes the costs of an average payphone:

<b>Table 2</b>			
<b>Payphone Cost Calculation</b>			
	Cost	Probability	Weighted Average
Payphone	222.51	1.00	222.51
Programming	45.00	1.00	45.00
Rate File	23.67	1.00	23.67
Pedestal	75.83	0.46	34.88
Enclosure	66.50	0.74	49.21
Other	141.67	0.19	27.05
Cost of installing payphone equipment	175	1.00	175
LEC line connection charge	54.5	1.00	54.5
Total			631.81

Using a rate of return of 11.25% and combined federal, state, and local taxes equal to 39.25%, MCI calculated the monthly payments that would be required to depreciate the \$631.81 investment over 10 years as \$11.60 per month.<sup>36</sup>

**B. Bad Debt Should Not Be Included**

RPC has now included an estimate of the cost of bad debt. It argues that the Commission declined to include this element in its Third Report and Order cost calculations solely because the Commission did not have reliable data on bad debt.<sup>37</sup> RPC now seeks recovery of the

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<sup>35</sup> MCI was unable to obtain the LEC line connection charges for 20 states. Given the wide variation in charges, it is unlikely that data from the remaining states would substantially alter the average line connection charge.

<sup>36</sup> Third Report and Order, & 169.

<sup>37</sup> RPC Petition at 10.

amount of bad debt written off. The Commission should not include this element, because in its Fifth Reconsideration Order it has already determined that Section 276 does not permit one company to bear another company's expense.<sup>38</sup> Including an element for bad debt would unfairly shift the burden of non-paying LECs and interexchange carriers ("IXCs") onto those that do pay.

C. Collection Costs Should Not Be Included

RPC and APCC both include estimates of their dial around collection costs.<sup>39</sup> RPC's estimate should be rejected because it includes the costs of validating calling cards, collect calls, and billed-to-third party calls in addition to identifying the IXC responsible for DAC. IXCs would have a need to validate calling cards, and operator services providers would have a need to validate collect calls and third-party-billed calls, but these are not necessary functions for PSPs. Consequently, they should not be included in the DAC calculation.

APCC has a different conception of collection costs. It measures collection costs as the revenues PSPs pay to aggregators to bill IXCs on their behalf. However, APCC's survey did not direct responders to exclude such costs from sales, general, and administrative costs ("SG&A"). The Commission therefore should not include APCC's collection element in order to avoid double counting.

D. PSP Call Volume Estimates Are Biased Downward

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<sup>38</sup> Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996, CC Docket No. 96-28, Fifth Order on Reconsideration and Order on Remand, & 82 (rel. October 23, 2002)("Fifth Reconsideration Order").

<sup>39</sup> RPC Petition at 10, APCC Petition at 13.

APCC measures volumes of calls at marginal payphones according to dial around calls for which PSPs received compensation.<sup>40</sup> The magnitude of the collection problems alleged by APCC during the time of its survey throws into doubt the validity of its call volume estimates. Moreover, neither APCC, nor RPC, exclude call volume data from locations that did not fully recover their costs, one of the conditions the Commission used to define marginal payphones.<sup>41</sup> Consequently, both studies may include phones with sub-marginal volumes.<sup>42</sup> The Commission should request RPC and APCC to resubmit their studies based on data derived from samples that do not contain the call volume errors identified here. If the Commission declines to do this, a reasonable correction would be to use average, rather than marginal, call volumes. It could weight APCC's 233.9 estimate by the ratio of RPC's average to marginal call volume, a factor of approximately 1.16.<sup>43</sup> Thus, RPC's call volume would be 253, and APCC's call volume would be 270.

#### E. Revenue From Increased Coin Calling

Another adjustment the Commission should make if it calculates a new default compensation rate is to reduce the per call recovery amount by the extent to which coin revenues exceed the rate sufficient to recover costs plus a normal return. The purpose of the

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<sup>40</sup> APCC Petition at 13, fn 20.

<sup>41</sup> Third Report & Order, & 179.

<sup>42</sup> RPC Petition at 12 adjusts average call volumes downward by the net revenues earned per phone in order to estimate a marginal call volume. This method assumes that PSPs have not valued site locations more highly (that is overpaid site owners) than site owners value having a payphone. MCI believes this method therefore overstates call volumes, and should not be used by the Commission.

<sup>43</sup> RPC Petition at 14-15.

Commission's default compensation rate is to return a rate that allows a PSP to recover costs plus a normal return, but no more. PSPs would be over-recovering the extent to which coin revenues exceed the per-call cost calculation. Table 3, below, shows that \$.34 per call will fully recover payphone costs and allow a normal profit. The current coin rate is \$.16 above that amount, and since coin calling accounts for 67.91% of calls,<sup>44</sup> PSPs would be earning nearly \$.11 more per call than needed to earn a normal profit.<sup>45</sup> Consequently, the per-call default rate should be reduced by that amount.

F. The Commission Has Already Dramatically Increased The Profitability Of PSPs By Doubling Per-Payphone Compensation

In its Fourth and Fifth Reconsideration Orders, the Commission adopted a new per-payphone method for reimbursing PSPs when a carrier could not know what to compensate because it relied on coding digits to make that calculation.<sup>46</sup> As a result of these Orders, MCI's per-phone payments doubled, increasing from 10 to 20 percent of its DAC payments. In order to recover this increased payment obligation, MCI was required to increase its surcharge to \$.43. AT&T increased its surcharge to \$.47 per dial around call. AT&T and MCI account for approximately 31 and 34 percent of dial around compensation calls respectively.<sup>47</sup> Assuming administrative costs of \$.04 per call, PSPs have been receiving an additional \$.11 per call since

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<sup>44</sup> APCC Petition, Summary of Average Call Volumes, by Call Type.

<sup>45</sup> .16 x .6791

<sup>46</sup> Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996, CC Docket No. 96-28, Fourth Order on Reconsideration and Order on Remand, (rel. January 31, 2002)(“Fourth Reconsideration Order”), and Fifth Reconsideration Order.

<sup>47</sup> Appendix C, Fifth Reconsideration Order allows one to calculate the market shares of AT&T and MCI.

the Fifth Reconsideration Order was implemented.<sup>48</sup> MCI will not make an adjustment for these increased payments in its calculations below, but presents this information as another reason why the rational policy in the event payphones further decline, is to broaden the availability of PIP programs, and to show that MCI's DAC calculations err by overstating required recovery.

G. Maintenance, Monthly Access Line Costs, SG&A, And Interest

MCI does not have access to independent data on maintenance and SG&A costs. Therefore it utilized the weighted average of RPC and APCC data for these items, and monthly access line costs. MCI weighted their data by the relative dial around calls paid to LEC PSPs (67%) vs. Independent PSPs (33%). MCI also applied an interest rate of 11.25% to the average four-month delay in accordance with the Commission's calculations in the Third Report and Order. MCI's calculations show that in the absence of additional coin revenue, it would take \$.34 per call to recover payphone costs and a normal return. After adjusting the additional \$.16 above this amount brought in from coin calls and adjusting for coin calling share of payphone calls, \$.24 per call would be sufficient to fully recover the costs of a payphone at an average location. If the Commission were to use the marginal call data supplied by RPC and APCC, even though their samples include sub-marginal phones and so bias call volume downward, it would take \$.40 to recover payphone costs and a normal return. After adjusting the additional \$.10 above this amount brought in from coin calls and adjusting for coin calling share of

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<sup>48</sup>  $(.39-.24) \times .31 + (.43-.24) \times .34$



payphone calls, \$.33 per call would be sufficient to fully recover the costs of a payphone at a marginal location.

Table 3					
Per Call Cost Calculations					
Rate	RBOC Data	%	APCC Data	%	Weighted Average
Payphone Costs Including, Equipment Installation and non-recurring LEC line installation costs					11.60
Monthly LEC Line Costs	37.86	0.67	38.77	0.33	38.16
Maintenance	13.81	0.67	17.45	0.33	15.02
SG&A	19.62	0.67	23.43	0.33	20.89
Subtotal					85.67
Average Call Volume	253.00	0.67	270.21	0.33	258.72
Cost Per Call					0.33
Interest 4 months @ 11.25%					0.01
Total					0.34
	Extent Coin Rate Contributes To Above-normal Profits (per-call)		% Coin		
Additional Revenue from coin calling	0.16		67.91%		0.11
Dial Around Rate Needed for Profitability					0.24

## V. CONCLUSION

Although the number of payphones has significantly declined since 1999, PSPs have failed to provide evidence that this decline has impeded the public's ability to make transient phone calls. Heretofore, the Commission believed that state PIPs and market forces would ensure the proper supply of payphones. If the Commission now believes that these mechanisms permit payphones to be removed from locations where they are needed, it should require states that do not have PIPs to implement such a program, and consider requiring all states to better advertise the availability of their PIP and advertise how to request a subsidy for a needed payphone. MCI has also shown that the decline in payphone costs along with additional coin revenue has offset the decline in payphone calling volumes, such that either no increase, or only a modest increase in DAC is justified. MCI urges the Commission to reject doubling the default DAC rate as a mechanism to ensure the public's need for transient calling is met. The substantial decline in the price of wireless service plans has drastically reduced the public's need for payphones, and if that need is being unmet in specific locations, states should be required to target subsidies to those locations. MCI urges the Commission to adopt its proposed recommendations.

Sincerely,

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## Statement of Verification

I have read the foregoing and, to the best of my knowledge, information and belief, there is good ground to support it, and it is not interposed for delay. I verify under penalty of perjury that the foregoing is true and correct.

Executed on January 07, 2003

Larry Fenster

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